The clauses relating to the exercise of power within the company

In our previous « MNKS booklet » dedicated to shareholders' agreements[1], we briefly described the main contractual and statutory clauses that are designed to restrict the transferability of shares of a company, to ensure the maintenance of the structure of the share capital and to organise the withdrawal in whole or in part of some of the company's shareholders in certain circumstances.

In addition to these clauses concerning the company's capital, there is another category of fundamental clauses present in almost all shareholders' agreement relating to Luxembourg companies and/or to their articles of association: clauses relating to the exercise of power within the company[2].

As their name implies, these clauses tend to control the exercise by certain shareholders[3] of their voting rights or their influence on the company or to personalise the functioning of the bodies of the company beyond the rules foreseen by the law of 10 August 1915 on commercial companies (as amended) (the "**LCC**")[4]. The clauses pursuing the first objective mentioned above are mainly voting commitments, procurement commitments ("*engagements de porte-fort*"), limitations on voting rights, irrevocable voting mandates, consultations prior to decision-making, general policy statements etc. The clauses pursuing the aforementioned second objective are mainly clauses that tend to govern either the operation of the general meeting or the composition or functioning of the management bodies of the company.

This fourth « MNKS booklet » on shareholders' agreements will only focus exclusively on these last clauses centered on the functioning of the bodies of the company, that are generally present (in a more or less developed way) in all shareholders' agreements that are somewhat detailed or which, when they are not included in the shareholders' agreement, are directly included in the articles of association of the company. It will only focus on these clauses regarding the two most traditional Luxembourg companies, namely the public limited liability companies ("*sociétés anonymes*")[5] and the private limited liability companies ("*sociétés à responsabilité limitée*")[6].

We will analyse successively below (without this list being intended to be exhaustive) the clauses relating to: (a) the allocation of the directors' mandates, (b) the adjustment of the quorum and majority rules within the management body and/or the general meeting, (c) the adjustment of the voting rights within the management body, (d) the adjustment of the respective powers of the management body and the general meeting and (e) the limitation or extension of the powers of the day-to-day management.

The purpose of the **clauses relating to the allocation of directors' mandates** is to enable one or more shareholder(s) to have a certain degree of representation at the level of the management bodies of the company. The most common ones aim to ensure that their beneficiary(ies) are assured of having one or more of their representatives in the board of directors or in the board of managers of the company (the "**Board**"). It is indeed fundamental to benefit from such representation in the Board, as the latter is the body which has the general and residual management power[7] of the company, i.e. the most extensive powers[8] for not only deciding on management actions, but also representing the company collectively, in all circumstances.

The two techniques most frequently used to achieve this objective are either traditional shareholders' voting commitments or a clause[9] known as "presentation of candidates" by certain persons[10]. But other

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[1] This term naturally refers to any agreement concluded between "actionnaires" or "associés" of a company.
[2] Also referred alternately to in doctrine as "power adjustment clauses", "power sharing clauses" or "power adjustment and power sharing clauses".
[3] Or sometimes also, but not without problems, as will be explained in more detail below, some members of the management bodies.
[4] Some authors also include among the clauses relating to the organization of power, enhanced information clauses tending to organize a broader right to information than that foreseen by the LCC for certain shareholders.
[5] Operating with a monistic and non-dualistic management body, although the LCC allows it perfectly.
[6] Operating with a management college and not with one or more managers with individual or joint management powers.
[7] At least in public limited liability companies managed under a monist system and private limited liability companies that have opted for a collegial management system.
[8] With the exception of those expressly reserved by the LCC or the articles of association for the general meeting.
[9] Which will always be included in the company's articles of association.

solutions (less known or obsolete practices) can also be used to "channel" or "direct" otherwise the power of the general meeting to appoint members of the Board. This includes, for example, "mandatory application clauses" or "quality clauses"[11] [12].

The possibility for a shareholder to ensure that one of his representatives is appointed as a delegate for day-to-day management of the company is more complex. Such appointment falls within the competence of the Board, whose doctrine generally supports that it could not be validly bound by voting commitments. As a result, according to some authors, agreements between shareholders regarding such appointment could, in turn, see their validity challenged if they are assimilated to a voting agreement between directors/managers. Fortunately, alternatives exist - if necessary - to increase the legal certainty of the mechanism of appointment of the delegate for the day-to-day management, for example to allow the general assembly to take such a decision.

The shareholders will also ensure, if necessary, that they share out, through contractual or statutory provisions (as the case may be), the (vice) presidency of the Board, the secretariat of the Board, the seats on the various advisory committees that would be created by the Board... They will also ensure that if the company has subsidiary (ies) and, if necessary, depending on the composition of their ownership, they organise the allocation of existing director's mandates within the subsidiary(ies)[13].

It should be noted in conclusion that these clauses concerning the distribution of mandates do not have any limits on the appointment of the company's auditor and are not without limits either. In particular, let us simply recall the existence of article 31 of the law of 23 July 2016 on the audit profession[14].

The **clauses relating to the amendment of quorum and majority rules within the management body and the general meeting** are also extremely frequent in shareholder's agreements[15]. In public limited liability companies the LCC foresees by default an attendance quorum of at least half of the directors present or represented and a simple majority of the directors present or represented for the votes[16]. On the other hand, the LCC is silent regarding the management body in private limited liability companies. By analogy, the rules laid down for public limited liability companies should logically apply. The shareholders often decide by agreement and by the articles of association to increase the quorum and majority conditions foreseen in the LCC, to ensure that certain important decisions cannot be taken without the consent of their representative(s) in the Board. Such an increase in the quorum and majority conditions foreseen in the LCC, up to unanimity and the establishment of a mechanism for important decisions, generally does not raise any questions in doctrine and case law. On the other hand, a reduction of the quorum and majority conditions is, in our opinion, likely to raise a problem, particularly with regard to the collegial nature of the Board[17]. However, the doctrine seems - voluntarily or not - to conceal the subject. The use of a more stricter quorum and majority rules than those foreseen by the LCC has one setback: that of multiplying the risks of blocking at the level of the management body. The practitioner, who uses it should therefore at the same time ensure to prevent, as far as possible, the unintentional occurrence of such blockages or foresee mechanisms to end them quickly in the interest of the company.

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[10] Generally being either shareholders of a certain category, or namely defined shareholders when their anonymity is not a problem, or shareholders holding a participation of a certain importance, or another body or committee of the company, or more rarely by a third party (such as a creditor).

[11] The doctrine generally considers that the right to appoint members of the Board is a competence strictly reserved to the general meeting and of which it could not be directly or indirectly deprived. It is this rule that explains, notably, that in a presentation clause, the number of candidates proposed by shareholders must always be at least one unit greater than the number of executive positions to be filled.

[12] As well as the principles governing voting commitments if they are structured in this way and, according to some Belgian minority authors, also the ius fraternatis, equality between shareholders and the social interest, even all three cumulatively.

[13] In compliance with any additional limits imposed by local law.

[14] Which states that: "Any contractual clause which limits the choice of the general meeting of shareholders or members of the audited entity pursuant to the first subparagraph to certain categories or lists of auditors, approved audit firms or audit firms with regard to the appointment of an approved auditor, an approved audit firm or an audit firm in particular to carry out the statutory audit of the accounts of that entity shall be prohibited. Any existing clause of this type is invalid and void."

[15] It is essential to include them in the articles of association to ensure their effectiveness. However, under Belgian law, the doctrine seems to accept that such clauses, when they concern the rules of deliberation of the general meeting, could only appear in a shareholders' agreement. The authors, having examined this question, consider that there is nothing to prevent shareholders from "committing themselves [conventionally] to vote at the general meeting in the sense defined by a majority which will have previously been reached between them under other conditions than those provided for in the articles of association".

[16] With a casting vote of the president in the event of parity, unless otherwise stated in the articles of association.

[17] Probably more in the public limited liability company than in the private limited liability company, since in the latter the basic principle is that the company is managed by one or more managers, which cannot be the case in a public limited liability company (not composed of a single person).

In the same way, without prejudice to the special rules of quorum and/or majority, in particular for extraordinary general meetings, the quorum and majority rules applicable by default for an ordinary general meeting of a public limited liability company are respectively as follows: at least one share present or represented and a majority of the expressed votes. In private limited liability companies, on the other hand, the rules applicable are as follows: at least half of the corporate units and if it's not possible to have this majority/quorum for the first meeting, then the second meeting can decide with the simple majority of the expressed votes regardless of the number of corporate units present or represented[18].

At the level of the Board, an increase in the quorum and majority requirements applicable to ordinary general meetings does not generally raise any particular problems, as long as it does not undermine the public policy rules. Thus, for example, the possibility of increasing the quorum and majority rules for the dismissal (ad nutum) of a director in a public limited liability company remains subject to fierce doctrinal controversy (still not fully determined by case law). In the same way no particular problems are raised - under the same reservations – in the case of an increasing of the quorum and majority rules in extraordinary general meetings. However, it is not possible to lower the quorum and majority rules foreseen in the LCC[19].

The **clauses relating to the adjustment of the voting right at the level of the management body** are less frequent and far more controversial. These clauses include in particular voting commitment clauses and double or proportional voting rights clauses at the level of the Board.

Without going into detail, the validity of voting agreements at the level of the Board is controversial. Part of the doctrine considers that the members of the Board could not be validly bound by such agreements[20]. This is mainly due to the fact that their voting right is a functional right and that the liability they incur in the exercise of their mandate would be an obstacle to the legality of such agreements. However, another part of the doctrine argues in favour of the validity of such agreements, as long as they respect - when the time has come - the social interest. It should be noted that, according to a small number of authors in Belgium[21], the illegality of voting agreements at the level of the Board would even affect the procurement commitments ("engagements de porte-port") by which a shareholder promises to ensure that its representatives in the Board vote in a predetermined way. The illegality of such agreements is however, more and more often called into question by Belgian and French doctrine, which have an indirect influence in Luxembourg.

With regard to the possibility of introducing a double or proportional voting right at the level of the board, Luxembourg doctrine is strongly attached to the principle of "one vote per person". This situation is thus different in particular from Belgian law, in which part of the doctrine convincingly argues in favour of the possibility of introducing a double voting right at the level of the Board in a Belgian public limited liability company, provided that it does not affect the collegial nature of the deliberations. In particular because it would allow, for example, in certain cases to limit the size of the Board in the event of a fragmented minority shareholding with representatives in the Board.

The **clauses relating to the adjustment of the powers of the management body and the general meeting** are also a great classic in shareholders' agreements and articles of association. These are clauses intended to impose certain internal restrictions on the powers of the Board in favour of the general meeting.

They generally involve the transfer of certain decisions which, according to the LCC, fall under the authority of the Board, at the level of the general meeting. Their validity is generally accepted by the doctrine, provided that they do not harm the structure of the company and/or violate the principle that the Board cannot fully divest its powers. In the event of use of such clauses, in our view, it would be prudent to ensure that the shareholders do not become de facto managers of the company, with all the consequences that this could have for them in terms of liability.

It seems to us that the enforceability of such clauses are limited to the internal order of the company. Indeed, the restrictions on the powers granted to the Board by the LCC and which result either from the articles of association or from a decision of the competent bodies, are unenforceable against third parties even if they are published.

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[18] Except if this possibility is excluded by the articles of association.

[19] Except if the LCC expressively foresees this possibility, as for example in the case of an approval in private limited liability companies, where the LCC foresees a range between 50% and 75%.

[20] Except where, according to certain authors, their object is limited to organizational questions and questions about the functioning of the Board.

[21] Where the voting agreements of directors are mostly recognized as illicit.

Finally, the **clauses relating to the limitation or extension of the powers of day-to-day management** while being less numerous without being totally unusual deserve a last few words.

As a reminder, the LCC foresees the possibility for the Board to delegate the day-to-day management of the company's business, as well as the representation of the company with regard to this management, to one or more persons acting alone or jointly. However, the law does not define this fundamental notion of day-to-day management. Its definition has therefore to be found in doctrine and case law, with the result that there is no clear definition[22]. This leads some shareholders to want to specify contractually and/or statutorily the notion of daily management, by broadening or narrowing it in relation to their understanding of its signification. Such clauses are certainly not invalid in the internal order. But they will pose problems in the external order, i.e. problems of opposability by third parties.

CONTACT

Jean-Philippe Smeets
Head of M&A
smeets@mnks.com
T: +352 26 48 42 1

Mélissandre Demarcq
Associate
demarcq@mnks.com
T: +352 26 48 42 1

[22] In Luxembourg the usual understanding of the notion of day-to-day management is generally the one reached at, at a certain time in Belgium: "the acts or operations which do not exceed the needs of the daily life of the company or the needs which, because of the little importance they represent and because of the need for a prompt solution to be achieved, do not justify the intervention of the Board".